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GOVERNMENT OF ALBERTA

SUBMISSION TO THE COMMITTEE OF INQUIRY ON CROW BENEFIT PAYMENT

OCTOBER, 1984

The Western Grain Transportation Act

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INTRODUCTION

Alberta welcomes the opportunity to put before this Commission of Inquiry its views on one of the most important issues to arise out of the Western Grain Transportation Act - that of how the Federal Government should pay the Crow Benefit.

The method chosen for paying the government subsidy in respect of grain transportation has serious implications for the future development of the agriculture sector and the grain handling and transportation system. Prior to passage of the WGTA, numerous Western Canadian farm groups put forward arguments in support of a method of payment that would have most, if not all, of the Crow Benefit paid directly to producers. In its Submission to the House of Commons Standing Committee on Transportation hearings, the Province of Alberta advanced compelling arguments that further supported this approach. The Federal Government had previously recognized this position on method of payment in its February 1, 1983 Western Transportation Initiative. They stated:

> "A system of payment to producers would provide increased scope for economic decision making by individuals and, in consequence, give more play to market forces. Of particular importance is that it would reduce existing economic distortions and, in the medium term, should lead to greater efficiency in the grain transportation system."

The Western Grain Transportation Act has already shown itself to be less than sensitive to forces in the market place and, as a result, opportunities to introduce efficiency into the agriculture and grain transportation systems are being restricted. The task of the committee as indicated in the WGTA is to:

> "Examine all matters that, in its opinion, pertain to the method of payment in respect of grain transportation that would be the most conducive to agricultural development in Canada."

This will involve determining how best to ensure that Western Canada's agricultural diversification and growth potential is fully realized and to promote grain system efficiency. The current method of payment mitigates against these objectives.

BACKGROUND

a) Primary Agricultural Production

With more than 31 million improved acres, Alberta has approximately 30 percent of Canada's farmland. Each year, additional land is brought into production through land clearing and breaking. It is estimated that another 10-20 million acres in Alberta could be improved and brought into our agricultural base. Of these acres, approximately 5.5 million could, over the long term, be brought under cultivation.

The trend in Alberta, as in other regions of Canada, is toward larger farms through consolidation. Technological change, economies of scale, etc., now allow producers to successfully operate considerably larger farms than was possible 20 years ago. In addition, total crop production has increased sharply over the same period. Farmers in Alberta produced nearly 11 million tonnes of crop products in the early 1960's. By 1983, this total had risen to more than 24 million tonnes. Alberta accounted for approximately 24 percent of the Canadian total.

Increases in livestock production have also been significant. Alberta's share of national cattle and calf production has increased substantially from 1961 to 1981. Producers in Alberta maintain nearly one-half of Western Canada's cattle and calves, or one-third of the Canadian total.

In contrast to cattle, Western Canada's share of hog production has declined from 48 percent in 1961 to 29 percent in 1981. Even though the national herd grew by 4.5 million head, hog production in Alberta has experienced relative decline. Alberta's share of Canadian pork production dropped from 20 percent in 1961 to 12 percent in 1981. Alberta farmers compete on world grain and livestock markets, with primary agricultural exports estimated at more than $2 billion per year.

b) Processing

Food processing contributes more than $3.5 billion annually to the Alberta economy. Animal slaughter and meat processing represent approximately one-half of this value, while dairy and oilseed processing each constitute 10 percent.

Agricultural processing in Alberta is dominated by meat processing companies which ship more than 80 percent of their output out of the province.

There are also other components of Alberta's processing sector which contribute substantially to the Alberta economy. The southern part of the province is a major producer of sugar beets for processing into sugar. There are 14 alfalfa dehydrating plants producing in excess of 200,000 tonnes of dehydrated alfalfa pellets and cubes. Vegetables, dry beans, potatoes, mustard seed, forage seed and honey are also expanding crops and offer potential for the future.

Another major component of Alberta's processing sector is oilseed processing, involved mainly with crushing canola seed into oil and high protein meal. Although Western Canada exports canola oil and meal to foreign countries, Central Canada is a major market for canola oil.

A large potential processing capability exists within the province. Alberta has encouraged and supported the value-added processing sector through technical assistance and various financial programs. Therefore, the method of payment and its potential impediment to further processing development is of particular concern to the province.

c) Transportation

Distance from ocean port, large population concentrations, relatively large internal distance between commodity consumption or production centres, and a relatively sparse population all combine to make Alberta industries and individuals extremely conscious of the importance of transportation to economic development.

It was the completion of the transcontinental railway that opened Alberta for major economic development. The province of Alberta has a less extensive rail system serving its grain industry than other provinces. Therefore, the cost impact of an extensive branchline network should be much less than for other provinces, but because of the averaging of rail costs across the prairies, the benefit is not realized by Alberta producers. There are currently about 11,000 kilometres of rail line in the province.

The province has also been instrumental in the provision of a good road system. There are currently over 24,000 kilometres of paved rural roads and highways. For most commodities, trucks offer stiff competition to the railways in terms of both cost and convenience. The major bulk resource products are, however, still primarily handled by the railways. Grain shipments out of Alberta in the 1983/84 crop year total approximately 10.8 million tonnes, or 32 percent of total prairie movements.

In the seven year period ending 1982/83, the number of primary elevators in Alberta has fallen from 1,330 to 899, and the number of elevator points has been reduced to 343 from 441. A rationalized system should result in reduced handling and transportation costs for farmers and lead to an efficient, effective and economic, least-cost system.

ALBERTA OBJECTIVES

Alberta's commitment to improving Canada's grain handling and transportation system is reflected in the province's investment in the grain hopper car fleet, inland grain terminals and by providing financing for the new grain terminal at Prince Rupert. Alberta has also actively

sought to improve the grain system through appropriate changes to policy, so as to improve Western Canada's prospects for agricultural growth and efficiency.

Throughout, the province has been guided in its approach by adherence to a consistent set of principles applied to grain transportation policy. These principles are:

- retention of the "Crow Benefit" for farmers;
- removal of disincentives to value-added processing;
- improvement in rail capacity and efficiency;
- provision of adequate revenue for railways relative to the costs of moving grain; and
- legislated and regulated rate formulas.

There is a noteworthy similarity between the Alberta Government principles and the policy objectives as originally presented by the former Federal Government. These principles are also similar to the ones stated by the new government with respect to its grain handling and transportation position. Farm organizations across Western Canada have generally accepted criteria similar to the Government of Alberta, as reflected in their public statements and submissions to various commissions. As well, a common understanding of the significance of the method of payment exists and a recognition of the need for its resolution is also present.

ISSUES

Alberta's agriculture sector differs from those of the other prairie provinces. The greater importance of the livestock and processing sectors means that Alberta is concerned with having a method of payment that will be sensitive to and will encourage the development of these and other sectors of our agricultural economy. No less important are the special demands placed on our transportation system as a consequence of having a diverse agricultural sector.

Until January 1, 1984, Western Canada's agricultural development took place under a fixed statutory rail freight rate regime. Statutory rates for grain were compensatory until the 1950's. Since then, the grain freight rate paid by farmers has become a successively smaller proportion of the full cost of moving grain. This was particularly the situation during the 1970's when Canada experienced high levels of inflation. The influence of a non-compensatory export freight rate on agriculture and transportation system development occurred slowly but nonetheless was pervasive. As rail revenues fell, the railways attempted to limit their losses on grain movement by postponing investment in the rail grain system. This resulted, over time, in insufficient rail car capacity, poorly maintained branchlines, and lack of efficient rail grain operations. The capacity limitations finally affected grain sales during

the 1978/79 crop year when an inability to move the required tonnage and appropriate grades of grain resulted in ship demurrage, contract deferrals and lost grain sales.

In addition, the lack of a compensatory freight rate affected the pricing of prairie feed grains. The pricing distortion, as indicated by higher feed grain prices than would have been the case under compensatory railway rates, along with the capacity constraints of the rail system, resulted in depressed feed grain prices at one point in time and extremely high prices at other times. This caused exaggerated swings in livestock production and marketing throughout the 1970's. For these reasons, Alberta requires a method of payment that will encourage the development of a diversified agriculture sector and, at the same time, provide an efficient transportation system that is responsive to the needs of its users.

Regardless of the method of payment of the benefit, inflation and increasing volume will increase the share of the grain freight rate paid by the farmer. Therefore, the net cost of rail transportation and the farmer's ability to pay higher freight rates is not significantly affected by method of payment in the short run. A payment direct to farmers over the longer term, however, offers a greater potential for changes to the grain collection and delivery system. To the extent that the changes, if and when they occur, result in a lower cost system, producers' ability to pay will be enhanced.

The following sections outline what Alberta considers to be the major areas of concern that can and should be addressed through an appropriate method of payment as it relates to agriculture and transportation system development.

IMPACT OF THE METHOD OF PAYMENT ON AGRICULTURAL DEVELOPMENT IN ALBERTA

It has been less than one year since the WGTA took effect. Freight rate increases to date are not of the magnitude that would bring about perceptible shifts in the direction of agricultural development in Alberta. There is no historical experience upon which we can base an assessment of future impacts of alternative methods of payment. Research and analysis findings with respect to alternative methods of payment vary to some extent with regard to the magnitude of the impact upon the grain, livestock and processing sectors. There is, however, broad general agreement as to the direction of these impacts.

There is significant potential to expand agricultural production and processing in Alberta. With regard to grain production, expansion will result from increased yields, reduced summerfallow and additional acreage under cultivation. At present, yield augmenting technology is not being

fully utilized. New varieties of feed barley, 3M wheats and canola show substantial potential to increase yields. Summerfallow acreage has been declining and this trend can be expected to continue as moisture conservation technology improves. Additional land is being brought into production through new breaking and through conversion of existing public and private grasslands. Although existing technologies will be the major contributor to increased production in the foreseeable future, it is likely that the development of new technologies will contribute to enhanced output at a future date.

The new statutory rail rate structure is so designed that farmers will bear an ever increasing portion of total grain transportation costs regardless of the payment mechanism. A decline in absolute level of farm grain prices will likely have little impact on the overall production of grain. Lower absolute grain prices may temporarily retard the rate at which additional land is brought into crop production. The long term trend, however, is not expected to change. Lower margins resulting from higher freight rates will place pressure upon farmers to continue to adopt yield enhancing technology and strive for economies of size. Therefore, total grain production can be expected to continue to expand at rates similar to those experienced over the past two decades.

Higher freight rates paid by farmers will result in a tendency to shift toward higher value crops such as oilseeds and special crops and, to some extent, wheat. The move towards higher value crops will depend to some

extent on the method of payment. Paying the Crow Benefit directly to farmers can be expected to result in somewhat greater shifts than would occur if payments are made to the railways. Shifts among crops, however, will not likely be large, regardless of the method of payment. Shifts toward more intensive but more diverse cropping patterns will be positive for the preservation of soils. It is, therefore, essential that farmers have the freedom to choose how best to combine their resources.

The future of the livestock industry also depends heavily upon the method of payment of the Crow Benefit. While livestock production normally accounts for about one half of Alberta's farm cash receipts, the potential exists for industry expansion. Freight rate distortions must be removed if the livestock industry is to be viable and achieve its potential.

Paying the Crow Benefit to the railways results in an artificially low export freight rate which in turn, raises the price of feed grain, the livestock industry's basic input. In the past, this impact has only occurred part of the time. Historically, lack of adequate grain transportation capacity and other constraints have, at times, resulted in large carry-over stocks of barley in Western Canada. When large carry-over stocks of barley occurred, the resulting price depressing effect of these stocks offset the price increasing distortion resulting from the Crow rate.

One of the objectives of the WGTA was to adequately compensate the railways and, thereby, ensure adequate rail capacity to export grain. Adequate rail capacity will reduce the frequency with which large carry-over stocks of barley occur. This, combined with an artificially low export freight rate, would do serious harm to Alberta's livestock industry.

Alberta feed grain prices are essentially determined by the export price less the costs of moving the grain into export position. Removing the distortion which results from an artificially low freight rate will, therefore, have a price lowering effect on feed grains in Western Canada. Carry-over stocks are inversely related to price. As carry-over stocks decline, prices will rise.

Feed grain prices, therefore, would not be expected to decline by the amount of the increase in rail freight rates because of the price rising effect of lower average carry-over stocks resulting from improved rail capacity. (1)

Resource constraints, both physical and managerial, will place limits on the rate of growth in the livestock industry resulting from the removal of distortions in the price of feed grains. The physical and managerial resource base, however, clearly exists within Alberta to develop a growth-oriented livestock industry provided that a market neutral environment exists.

Analysis by the University of Alberta of various methods of payment of the Crow Benefit indicates that paying the majority of the Crow Benefit in a neutral manner (pay the farmer) would result in annual growth rate increases of about 0.6% and 1.0% for cattle and hogs respectively above pay the railways methods.(2) Although the increase in the rate of growth in the Western livestock industry is modest, it is significant both in terms of farm income and economic diversification.

Markets for additional livestock production, resulting from a neutral method of payment, will be available. The domestic market can be expected to grow slowly. The Northwestern United States and offshore Pacific Rim are growth markets to which Western Canada's livestock products will likely be exported.

A resource neutral method of payment will result in more diverse farm production, both from crops and from livestock. Payment of the Crow Benefit in a neutral manner directly to farmers will increase Alberta's aggregate net farm income compared with payments directly to the railways.

The University of Alberta has estimated that pay the farmer or hybrid proposals (Gilson type) will increase net farm income by 1990/91 by about 20 to 30% from that which would result from payments directly to the railways.(3) Further, their estimates do not include the additional benefits to farmers arising from the pass-back of greater system efficiency gains resulting from a pay the farmer method of payment.

A viable, diverse and growth-oriented primary agriculture is fundamental to value-added processing in Alberta. Meat processing and diversified crop processing are vital to Alberta's economy. Alberta's agricultural processing industry requires a freight rate structure that does not discriminate between the export of raw grains and processed products derived directly or indirectly from those grains.

The economic activity that can result from removal of freight-related pricing distortions is crucial to Alberta. A stronger Alberta economy, however, is beneficial to the economy of all regions of Canada. Further, the growth in Alberta and the rest of the Western Canadian agriculture will not have a detrimental impact upon the agricultural development of other regions.(4)

IMPACT OF METHOD OF PAYMENT ON GRAIN HANDLING AND TRANSPORTATION SYSTEM DEVELOPMENT

The Western Grain Transportation Act included a number of features to increase the efficiency and performance of the grain handling and transportation system. Experience to date with the Act has not resulted in any noticeable institutional or regulatory reform, nor has the farmer been the beneficiary of any grain system cost reductions. Many of the

administrative measures introduced, such as the Senior Grain Transportation Committee and the expanded role of the Grain Transportation Agency, could have been facilitated under the old legislative framework.

In addition, while the farmer is facing increasing costs for transportation, he has not been given a proportionate increase in his control over the evolution and development of the grain handling and transportation system. The province strongly supports additional input by farmers into organizations such as the Senior Grain Transportation Committee, the Grain Transportation Agency and the Canadian Wheat Board in order to facilitate a move to greater efficiency in the grain handling and transportation system.

The method of payment issue has implications for the eventual size, structure and efficiency of the grain handling and transportation system. The impact upon capacity/infrastructure investment, modal choice and system configuration is discussed in this section.

The method of payment will largely determine who controls the decision making process involving capacity/infrastructure investment. When Crow Benefit payments are made to the railways, the prices that producers pay for transportation service bear little resemblance to the associated costs. Therefore, a greater amount of rail transportation is demanded for the shipment of statutory grains. The additional demands made of the rail system requires that additional investment be made in providing and

maintaining that system.

If producers paid the actual cost of rail service, and were reimbursed directly for the Crow Benefit portion of the costs, it is likely that they would seek a change in the structure of the current system in order to reduce their costs. This could lead to reduced rail branchline services and possibly an increase in the length of truck haul to grain assembly points at a lower overall cost. Thus, investment in transportation capacity would be determined by producers in accordance with the demands made upon the respective transportation services and determined through a market environment.

In addition, the producer, now receiving the benefit payments directly, has a number of alternatives to choose from. For example, there would be an incentive to purchase larger trucks, or to use commercial 'B' train units to further reduce transportation costs. Or, a producer could decide to produce and deliver alternative crops to the original statutory grains to domestic markets or local processors.

Crow Benefit payments made wholly and directly to the railways result in a modal bias towards the rail transport system since trucking rates cannot compete with the railway rates on the basis of the out-of-pocket costs to the producer. When payments are made to the railways for the movement of export grain, a bias also exists for the exporting of grain, resulting in a disincentive to the marketing of domestic grains.

Furthermore, the problem of having to separately compensate railways, other than CN and CP, for the hauling of grain as provided for in the WGTA is also a concern.

In alternatives which pay a portion of the benefit to the railways and producers, transport mode bias will continue to exist, but the bias will decrease over time with increasing costs and volumes. Thus, only in the case of payment to producers are resource neutrality and efficiency principles upheld. Payment to the railway and the hybrid alternatives result in less efficiency.

While rationalization of the elevator and railroad system has been taking place for some time, and is expected to continue in the future, the rate of consolidation and location of elevator facilities will be influenced to a large degree by the method of payment issue. Payment of the benefit to the railways provides little incentive for producers to move to more efficient, higher throughput elevator facilities on high density rail lines. Since costs are averaged and shared among all producers, there is little benefit to an individual pursuing innovative alternatives.

Both the hybrid alternatives and the pay the farmer approach to benefit payments could lead to incentives for the use of multi-car shipments from high throughput facilities. In such a case, one could expect a more rapid rationalization of elevator and rail facilities compared to pay the railway alternatives.

A number of efficient, high capacity elevators have been built over the last few years. The trend towards system rationalization across the prairies is expected to continue in the future. As producer freight rates increase, a demand for better service and a more cost-efficient system can be expected to develop. The system of charging producers full rail freight rates while paying the Crow Benefit to producers directly can be expected to accelerate this process as the producer faces much higher freight rates than under pay the railway alternatives and, therefore, demands system changes more quickly.

Pay the producer alternatives provide an incentive for greater innovation through such things as off-track elevators and truck/container assembly. This will result as producers seek a least-cost system. The producer will make use of the competitive market conditions to capture whatever gains can be realized from an efficient grain transportation and marketing system.

ADDITIONAL ISSUES

1. AGRICULTURAL ADJUSTMENT FUND

In the Gilson deliberations, it was determined that the funds allocated to effect a change in the Crow rate were insufficient to

allow for the recommended method of payment. Dr. Gilson, in his report, cited the need for additional funds to offset dilution of an individual Crow entitlement when payments are made directly to producers. Dilution, as used here, is a reduction in the share of the Crow Benefit originally accruing to export grains caused by sharing the Crow Benefit with all grains. The Federal Government recognized the validity of this concern and made available an Agricultural Adjustment Fund at the time of the Western Transportation Initiative. These additional funds are a necessary ingredient in the formula for a comprehensive solution to the question of the method of payment.

2. VOLUME CAP

The removal of the 31.5 million tonne volume cap on grain shipments, as called for by many agricultural groups, and as enunciated in the Progressive Conservative election platform also has implications for agricultural development. The removal of the cap will result in increased financial protection for the grain producers and removal of the disincentive to increased grain shipments, but will also exacerbate the distortion in grain pricing from the livestock producer and value-added sector perspective. For this reason, a producer payment mechanism is even more vital for a viable Alberta processing sector.

3. UNITED STATES CONCERNS

After the passage of the WGTA which expanded the number of commodities receiving freight rate subsidies, the United States Government raised the possibility of challenges to the subsidies under the provisions of the General Agreement on Tariffs and Trade (GATT). It would appear that the products added to the new Act could be challenged because the rate subsidies apply primarily to export movements and, therefore, could be perceived as an export subsidy. If, however, the Crow Benefit payments were made to producers, with producers paying full transportation costs of both export and domestic product shipments, possible challenges under the provisions of GATT would be less likely to succeed.

4. OTHER ISSUES

A number of other issues related to the Method of Payment have been raised by various parties over the past several years. Rather than list and discuss each separately, we would refer the Commission to the discussion of such issues contained in Chapter VI of the University of Alberta document referred to previously in this submission.

SUMMARY

The strength of prairie agriculture lies in the abundant land resources and the management skills of its farmers. Farmers have shown an exceptional ability to adapt new technology and new husbandry techniques in their persistent drive toward increasing production and improving farm incomes. The interests of Canada, as a whole, and the prairie farmer in particular, can best be served by enhancing the capability of the farmers to make decisions which improve individual farm incomes.

Farmers have rightfully expressed concern about the lack of adequate system investment and improved railway performance. Producer involvement is essential in the future development of a grain handling system which so vitally affects their economic viability. A system where 150,000 farmers receive the Crow Benefit directly will guarantee farmers' direct control over the functioning of the system. Additionally, the permanence of the Crow Benefit becomes more secure when individuals are making economic decisions based, to some degree, on receipt of monies. Payment directly to the railways does not provide this security of permanence and is less attractive for farmer control of the development of the grain transport system.

The collective response from a payment to farmers will result in a greater economic benefit than that which would result from a payment to the railways. Farmers can best decide where to allocate their resources, whether these resources be in the form of land, labour or in the form of capital, including a "Crow Benefit" payment.

The present method of payment directs farmers toward the export of grain. Grain exports have become an important source of foreign exchange and as such, export sales have benefitted the whole Canadian economy. The question which remains, however, is whether the resources allocated to the production of grain for export are realizing an optimum return to the individual farmer and the Canadian Public as a whole.

The development of the livestock and other value-added industries in Alberta demonstrates that prairie resources can be employed effectively in the production of commodities other than grain and similarly benefit the Canadian economy. This development occurred in spite of a less than compensatory freight rate on export grains. The Western livestock industry will not reach its true potential if feed grain, the primary input, continues to be directed away from local stockmen by a subsidized freight rate to export markets. The optimum utilization of our resources will only be fully realized when local value-added industries are able to take full advantage of their location in the heart of Canada's grain producing region.

The question before the Commission is to make recommendations as to the appropriate method of payment "in respect of grain transportation that would be the most conducive to agricultural development in Canada". The magnitude of the benefit is such that it represents a significant portion of net farm income. The opportunity exists to stimulate the economic growth and development of the Canadian prairies. Administrative issues should not deter the Commission from recommending the appropriate method of payment which would allow the capture of the opportunity which exists.

The recommendations of the Commission of Inquiry on the method by which the funds are distributed will direct prairie agriculture in the foreseeable future. A payment directly to the railways will lead prairie farmers away from livestock enterprises and toward the production of grain for export. A system of payments to producers will allow producers to develop a balanced and diversified agricultural sector involving both livestock and grain production. Payments to producers will allow them to choose a least-cost grain handling and transportation system as it evolves over time.

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